

State of Idaho

Legislative Services Office

Individual Entity Audit Report

A communication to the Joint Finance-Appropriations Committee

IDAHO DEPARTMENT OF ENVIRONMENTAL QUALITY CLEAN WATER STATE REVOLVING FUND

FY 2010

Report OP24710
Date Issued: December 15, 2010

Serving Idaho's Citizen Legislature



Idaho Legislative Services Office
Legislative Audits Division

Don H. Berg, Manager

DEPARTMENT OF ENVIRONMENTAL QUALITY CLEAN WATER STATE REVOLVING FUND

SUMMARY

PURPOSE OF AUDIT REPORT

We have audited the financial statements of the Department of Environmental Quality (DEQ), Clean Water State Revolving Fund (CWSRF) for the fiscal year ended June 30, 2010, in accordance with auditing standards generally accepted in the United States of America. The purpose of our audit is to determine whether the CWSRF's financial statements are materially accurate and reliable, and that it complied with laws and regulations affecting fiscal operations.

CONCLUSION

We conclude that the CWSRF's financial statements are materially accurate and reliable, and fiscal operations materially comply with related laws and regulations. As a result, we issued an unqualified opinion on the CWSRF's financial statements.

FINDING AND RECOMMENDATION

There is one finding and recommendation in this report.

Finding 1 – Material errors in the financial statements were not detected by current internal control procedures.

PRIOR FINDINGS AND RECOMMENDATIONS

There were no findings and recommendations in the prior report.

AGENCY RESPONSE

The Department has reviewed this report, and its complete response to the one finding and recommendation can be found on page 17.

This report is intended solely for the information and use of the State of Idaho and the Department of Environmental Quality and is not intended to be used by anyone other than these specified parties.

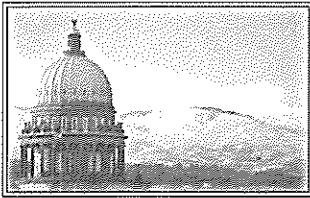
We appreciate the cooperation and assistance given to us by the director, Toni Hardesty, and her staff.

ASSIGNED STAFF

Chris Farnsworth, CPA, Managing Auditor
J.E. Bowden, CPA, CFE, In-Charge Auditor
Eric Bjork, Staff Auditor

TABLE OF CONTENTS

Independent Auditor's Report – Unqualified Opinion on Basic Financial Statements.....	1
Management's Discussion and Analysis.....	3
Statement of Net Assets.....	5
Statement of Revenues, Expenses, and Changes in Net Assets.....	6
Statement of Cash Flows	7
Notes to Financial Statements.....	8
Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	15
Finding and Recommendation	17
Agency's Response	18
Appendix.....	19



Legislative Services Office Idaho State Legislature

Serving Idaho's Citizen Legislature

Jeff Youtz
Director

December 15, 2010

Unqualified Opinion on
Basic Financial Statements

Independent Auditor's Report

Toni Hardesty, Director
Idaho Department of Environmental Quality
1410 North Hilton Street
Boise, ID 83706

Dear Ms. Hardesty:

We have audited the accompanying financial statements of the governmental activities, major fund, and the remaining fund information of the Idaho Clean Water State Revolving Fund (CWSRF) as of and for the year ended June 30, 2010, which collectively comprise the CWSRF's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the CWSRF's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business type activities, major fund, and the remaining fund information as of June 30, 2010, and the respective changes in financial position and its cash flow for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 15, 2010, on our consideration of the CWSRF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered when assessing the results of our audit.

Mike Nugent, Manager
Research & Legislation

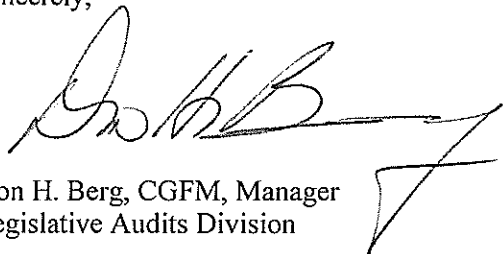
Cathy Holland-Smith, Manager
Budget & Policy Analysis

Don H. Berg, Manager
Legislative Audits

Glenn Harris, Manager
Information Technology

The Management Discussion and Analysis on pages 3 and 4 is not a required part of the basic financial statements, but is supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion thereon.

Sincerely,

A handwritten signature in black ink, appearing to read 'Don H. Berg', followed by a long horizontal line and a large, stylized '7' or 'Z' shape.

Don H. Berg, CGFM, Manager
Legislative Audits Division

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the CWSRF annual financial report presents our evaluation of the financial performance of the program for the State fiscal year (SFY 2010): July 1, 2009 through June 30, 2010.

OVERVIEW OF THE FINANCIAL STATEMENTS

The CWSRF basic financial statements include the Enterprise Fund financial statements and accompanying notes to the financial statements. The financial statements are presented in a three column format which separates loan activities and administrative activities. The Enterprise Fund financial statements consist of the following elements necessary for fair presentation:

- Statement of Net Assets – This statement presents information on all assets and liabilities of the CWSRF, with the difference between assets and liabilities reported as net assets.
- Statement of Revenues, Expenses and Changes in Net Assets – This statement presents all revenues, expenses, and the changes in net assets of the CWSRF. The information in this statement is segregated into operating revenues, operating expenses, and non-operating revenues.
- Statement of Cash Flows – This statement details the categorical sources and uses of cash within the CWSRF, and provides a reconciliation of income to net cash provided by operating activities.
- Notes to the Financial Statements – This section details the financial activities, accounting policies and practices, as well as specific account information for the CWSRF.

These financial statements provide additional information on the specific operations on the CWSRF than that which is presented in the State of Idaho, SFY 2010 *Comprehensive Annual Financial Report (CAFR)*. The statewide *CAFR* includes the CWSRF; the related but separate Drinking Water Revolving Loan Fund (DWSRF), which is also operated by the Idaho DEQ; and the Idaho Department of Water Resources loan program. Taken together, these three programs comprise the loan fund as reported in the Idaho *CAFR*.

FINANCIAL HIGHLIGHTS STATE FISCAL YEAR 2010

- The CWSRF made \$25.8 million in loan disbursements to Idaho communities for wastewater projects. The money used for these disbursements was from five primary sources: \$3.1 million from the U.S. Environmental Protection Agency (EPA) CWSRF capitalization grants; \$0.7 million from Idaho matching funds to the capitalization grant; \$3.4 million from the EPA American Reinvestment and Recovery Act (ARRA); \$3.1 million from the U.S. Department of Education ARRA, and \$15.5 million from revolving funds (collected loan repayments and related revenues).
- Loan repayments of \$10.9 million were received. Historically, the CWSRF has not experienced any loan defaults.

- Investments made by the Office of the State Treasurer earned \$0.1 million in interest on CWSRF cash deposits remaining in the Idle Pool, and \$1.6 million was earned by the Diversified Bond Fund.

CONDENSED FINANCIAL INFORMATION

	<u>FY 2010</u>	<u>FY 2009</u>
Total Assets	\$226,529,328	\$209,937,319
Total Liabilities	29,479	28,153
Total Net Assets	226,499,849	209,909,166
Operating Revenue	598,451	452,380
Operating Expenses	452,058	452,380
Non-Operating Revenue	15,539,048	10,928,045
Change in Net Assets	15,685,441	10,928,045

ANALYSIS OF FINANCIAL POSITION

The Idaho CWSRF continued to show growth in SFY 2010 as evidenced by the \$15.6 million increase in net assets. This growth in assets was primarily due to the consumption of federal grants and the growth of earnings on increasing balances of loans receivable and investments. During fiscal year 2010, EPA grants contributed \$6.5 million towards loan disbursements, Idaho matching funds contributed an additional \$0.7 million, and the U.S. Department of Education ARRA contributed \$3.1 million. The CWSRF earned \$4.4 million in loan interest revenue. Cash earned \$0.1 million, and investments earned \$1.6 million.

Loans receivable as of June 30, 2010, were \$165.0 million, an increase of \$16.5 million from the prior year. During the year, the CWSRF made loan disbursements of \$25.8 million, while collecting \$7.2 million from loan principal repayments.

Investments decreased \$0.3 million to \$47.5 million. During SFY 2010, investments earned \$1.6 million, while \$2.0 million in withdrawals from investments were made to provide liquidity.

Cash decreased \$2.5 million to a balance of \$8.6 million. This was primarily a result of making loan disbursements of \$25.8 million, of which most were made from revolving funds.

There are no known facts, decisions, or conditions expected to have a significant effect on the CWSRF.

STATE OF IDAHO - DEPARTMENT OF ENVIRONMENTAL QUALITY
 CLEAN WATER STATE REVOLVING FUND
 STATEMENT OF NET ASSETS
AS OF JUNE 30, 2010

	MAJOR FUND LOAN ACTIVITIES	NON-MAJOR FUND ADMINISTRATIVE ACTIVITIES	TOTAL
<u>ASSETS</u>			
Current Assets:			
Cash	\$7,895,323	\$0	\$7,895,323
Cash - Loan Service Fees	0	740,793	740,793
Investments	49,771,519	0	49,771,519
Interest Receivable - Fund Balance	138,236	0	138,236
Interest Receivable - Loans	1,743,959	0	1,743,959
Fees Receivable - Loans	0	244,774	244,774
Interest Receivable - Fees	0	808	808
Loans Receivable	5,766,026	0	5,766,026
Total Current Assets	\$65,315,063	\$986,375	\$66,301,438
Non-Current Assets			
Loans Receivable	\$159,214,784	\$0	\$159,214,784
Interest Receivable	675,018	0	675,018
Fees Receivable - Loans	0	338,088	338,088
Total Non-Current Assets	\$159,889,802	\$338,088	\$160,227,890
TOTAL ASSETS	\$225,204,865	\$1,324,463	\$226,529,328
<u>LIABILITIES</u>			
Current Liabilities:			
Payroll Payable	\$0	\$12,478	\$12,478
Operating Payable	0	12,233	12,233
Indirect Payable	0	4,768	4,768
Total Current Liabilities	\$0	\$29,479	\$29,479
TOTAL LIABILITIES	\$0	\$29,479	\$29,479
<u>NET ASSETS</u>			
Unrestricted	\$225,204,865	\$1,294,984	\$226,499,849
TOTAL NET ASSETS	\$225,204,865	\$1,294,984	\$226,499,849

The accompanying notes are an integral part of these financial statements.

STATE OF IDAHO - DEPARTMENT OF ENVIRONMENTAL QUALITY
 CLEAN WATER STATE REVOLVING FUND
 STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
 FOR THE YEAR ENDED JUNE 30, 2010

	MAJOR FUND LOAN ACTIVITIES	NON-MAJOR FUND ADMINISTRATIVE ACTIVITIES	TOTAL
OPERATING REVENUES			
EPA Operating Revenue	\$0	\$130,972	\$130,972
Loan Servicing Fee Revenues	0	467,479	467,479
Total Operating Revenues	\$0	\$598,451	\$598,451
OPERATING EXPENSES			
Program Administration			
Personnel	\$0	\$306,811	\$306,811
Indirect Admin. Expense	0	119,440	119,440
Operating Expense	0	25,807	25,807
Total Operating Expenses	\$0	\$452,058	\$452,058
Operating Income(Loss)	\$0	\$146,393	\$146,393
NON OPERATING REVENUES			
Contributions			
Contributions - EPA	\$9,684,996	\$0	\$9,684,996
Contributions - State	654,860	0	654,860
Investment Income:			
Interest Earned - Idle Pool	78,999	0	78,999
Interest Earned DBF	1,588,342	0	1,588,342
Interest Earned - Loans	4,425,041	0	4,425,041
Interest Earned - Loan Service Fees	0	8,650	8,650
Net Increase in Fair Value of Investments	1,608,378	0	1,608,378
Loan Forgiveness	(2,510,218)	0	(2,510,218)
Net Investment Income	\$5,190,542	\$0	\$5,190,542
Total Non-Operating Revenues	\$15,530,398	\$8,650	\$15,539,048
Change in Net Assets	\$15,530,398	\$155,043	\$15,685,441
Net Assets - Beginning of Year (as restated)	209,674,467	1,139,941	210,814,408
Net Assets - End of Year	\$225,204,865	\$1,294,984	\$226,499,849

The accompanying notes are an integral part of these financial statements.

STATE OF IDAHO - DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2010

	MAJOR FUND LOAN ACTIVITIES	NON-MAJOR FUND ADMINISTRATIVE ACTIVITIES	TOTAL
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash Received From EPA	\$0	\$130,972	\$130,972
Cash Received - Loan Service Fees	0	340,437	340,437
Cash Received - Loan Service Fees Interest	0	0	0
Cash Payments - Administrative Expenses	0	(450,733)	(450,733)
Net Cash Provided by Operating Activities	\$0	\$20,676	\$20,676
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES			
Cash Received From EPA	\$9,684,996	\$0	\$9,684,996
Cash Received as State Match	654,860	0	654,860
Net Cash Provided by Non-Capital Financing Activities	\$10,339,856	\$0	\$10,339,856
CASH FLOW FROM INVESTING ACTIVITIES			
Loans and Interest Cash Flows			
Cash Received - Loan Interest Payments	\$3,626,605	\$0	\$3,626,605
Cash Received - Loan Principal Repayments	7,240,293	0	7,240,293
Cash Received - Loan Service Fees Interest	0	8,650	8,650
Loan Disbursements	(25,802,202)	0	(25,802,202)
Cash Received - Investment Interest	1,698,084	0	1,698,084
Sale of Investments	2,000,000	0	2,000,000
Purchase of Investments	(1,612,335)	0	(1,612,335)
Net Cash Used by Investing Activities	(\$12,849,555)	\$8,650	(\$12,840,905)
Net (Decrease) Increase in Cash	(\$2,509,699)	\$29,326	(\$2,480,373)
Cash Balance - Beginning of Year	10,405,022	711,467	11,116,489
Cash Balance - End of Year	\$7,895,323	\$740,793	\$8,636,116
RECONCILIATION OF OPERATING INCOME TO NET CASH USED BY OPERATING ACTIVITIES			
Operating Income		\$146,393	\$146,393
Adjustments by Operating Activities			
Change in Payables	0	1,325	1,325
Change in Receivables	0	(127,042)	(127,042)
Total Adjustments	\$0	(\$125,717)	(\$125,717)
Net Cash Provided by Operating Activities	\$0	\$20,676	\$20,676
Noncash Transaction			
Investments increased in fair value by \$1,520,730.			

The accompanying notes are an integral part of these statements.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization of the Fund

The Clean Water State Revolving Fund (CWSRF) was established pursuant to Title VI of the Federal Water Quality Act of 1987 (the Act). The Act established the CWSRF program to replace the construction grants program and provide loans at reduced interest rates to finance the construction of publicly owned water pollution control facilities. Instead of making grants to communities that pay for a portion of building wastewater treatment facilities, the CWSRF provides a flexible financing source that can be used for a variety of pollution control projects. Loans made by the CWSRF must be repaid within 20 years (30 years for some disadvantaged communities), and all repayments, including interest and principal, must be returned to the CWSRF. The money in the CWSRF is to be used for eligible purposes in perpetuity.

The CWSRF is in the process of being capitalized by the U.S. Environmental Protection Agency (EPA) through a series of grants beginning in 1989. States are required to provide an additional 20% of the federal capitalization grant as matching funds in order to receive a grant. As of June 30, 2010, Congress authorized the EPA to award \$130,239,715 in capitalization grants to Idaho. The State is required to contribute \$26,047,943 in matching funds to receive these capitalization grants.

The American Recovery and Reinvestment Act of 2009 provides the CWSRF with \$29,239,100 of additional funding with no required State match.

The CWSRF is administered by the Idaho Department of Environmental Quality (DEQ). The CWSRF does not have any full time employees. Instead, DEQ charges the CWSRF for time spent on CWSRF activities by DEQ employees, and the CWSRF reimburses the DEQ Fund for such costs. The charges include the salaries and benefits of the employees, as well as indirect costs allocated to the CWSRF based on direct salary costs. Employees charging time to the CWSRF are covered by the benefits of the State. The CWSRF is also charged indirect costs of the State through the cost allocation plan for general State expenses.

The financial statements are intended to present the financial position and results of the operations of the CWSRF, a component of the State of Idaho. These statements are not intended to present the financial position or results of operations for the Idaho Department of Environmental Quality, of which the CWSRF is a part.

Basis of Accounting and Measurement Focus

Enterprise funds, in accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, are required to apply applicable GASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: *Statements and Interpretations of Financial Accounting Standards Board (FASB)*; *Accounting Principles Board Opinions*; and *Account Research Bulletins of the Committee on Accounting Procedures*. In addition, an enterprise activity may apply all FASB statements and interpretations issued after November 30, 1989, except those that conflict with or contradict GASB pronouncements. The CWSRF has elected not to follow FASB pronouncements issued after November 30, 1989.

The CWSRF presents its financial statements as an enterprise fund. Enterprise funds are reported using the economic resources measurement focus and the accrual basis of accounting. The State's central accounting system records transactions on a cash basis of accounting. The CWSRF financial records have been converted as necessary to an accrual basis. The accrual basis of accounting requires recording revenues when earned and expenses when incurred.

Operating and Non-Operating Revenue and Expenses

Operating and non-operating revenue and expenses are presented separately on the operating statement. Operating revenue and expenses result from transactions associated with the administrative activity of the CWSRF, for example, administrative expenses and contributions from the EPA and loan servicing fees for administrative costs. All other transactions are reported as non-operating revenue, such as loan disbursements, collections, interest earned, contributions from the EPA and the State for loan disbursements.

Cash and Cash Equivalents

Pursuant to Idaho Code, all cash of the CWSRF is deposited with the Office of the State Treasurer. The State Treasurer is responsible for the investment of the cash balances of the State.

In accordance with the Clean Water Act and Idaho Code, all cash of the CWSRF is perpetually appropriated for program purposes.

Capital Assets

Capital assets are generally defined as land, land improvements, buildings, fixtures, equipment, and property under construction, and are recorded at cost. The CWSRF owns no land, land improvements, buildings, fixtures, or property under construction and has no plans to acquire any.

Loans Receivable and Interest Capitalization

Loan funds are disbursed to the local agencies as the agencies incur costs for the purposes of the loan and request loan disbursements from the CWSRF. Typically, interest is calculated from the date that funds are advanced. After final disbursement has been made, the repayment schedule identified in the loan agreement is adjusted for the actual amounts disbursed and interest accrued during the project period. At the loan closing, the loan recipient is given the opportunity to pay off any accrued interest during the construction phase or to capitalize the interest into the loan principal, subject to the available debt capacity of the loan recipient as stated in the loan award.

Management considers all loans to be fully collectible; therefore, no allowance for uncollectible accounts is made.

Indirect Costs - Specific CWSRF Liabilities

Certain liabilities, such as compensated absences, pension plan obligations, and commitments under non-capitalized (operating) leases are obligations of the Department of Environmental Quality, and the CWSRF receives an allocation of these costs, either through direct expenses as incurred or through the application of a negotiated indirect rate.

For the year ended June 30, 2010, the CWSRF does not have separate specific liabilities for compensated absences, pension plan obligations, and commitments under non-capitalized (operating) leases.

State Match

Under Idaho Code, the State match is perpetually appropriated from the Water Pollution Control Account. The State is only required to deposit a cash match into the CWSRF when an actual cash draw from the EPA is made.

Loan Servicing Fees

To support the administration of the CWSRF in perpetuity, a loan servicing fee of 1% is assessed on the outstanding loan receivable balance. The fees are deposited to an account outside the CWSRF and will be used for administration costs of the program.

<u>Loan Servicing Fees</u>	
Beginning Balance - July 1, 2009	\$711,466
Collections	340,437
Interest Income - Loan Servicing Fee Account	8,650
Expenditures	<u>(319,760)</u>
Ending Balance - June 30, 2010	<u>\$740,793</u>

NOTE 2. CASH AND INVESTMENTS

The CWSRF participates in two of the State Treasurer's investment pools. In accordance with Idaho Code, Sections 67-1210 and 67-1210A, the State Treasurer invests in various types of investments, including certificates of deposit, repurchase agreements, securities lending, and federal, State, and local government securities.

The Idle Fund is an involuntary internal investment pool managed by the State Treasurer's Office on behalf of participants. Money not needed to meet immediate operating obligations is invested in the Idle Fund, which is unrated. The CWSRF has total deposits of \$8,636,116 in the pool. Deposits are stated at cost, which approximates market.

The CWSRF also participates in the Diversified Bond Fund (DBF), an unrated external investment pool. This pool is sponsored by the State Treasurer's Office under the authority of Idaho Code, Sections 67-1301 and 67-2328. As of June 30, 2010, the CWSRF investment in the DBF had a fair value of \$49,771,519, with a maturity of less than one year. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. In previous years, the fund had been reported at cost, which is lower than fair market value; therefore, the beginning Net Assets – Beginning of Year balance has been restated to reflect an increase of \$905,241. A copy of the State's *Comprehensive Annual Financial Report (CAFR)*, including the investment pool's financial statements, is available from the Office of the State Controller.

The State of Idaho has not adopted a formal investment policy that addresses credit and interest rate risk related to the Idle Fund and the DBF investments.

NOTE 3. LOANS RECEIVABLE

Extent, Nature, and Terms of Financial Instruments

The CWSRF makes loans to qualified agencies for projects that meet the eligibility requirements of the Act. Loans are financed by capitalization grants, State match, and revolving funds. Effective interest rates on loans range between 0% and 4.5% and are generally repaid over 20 years (30 years for some disadvantaged communities) starting within one year after project completion.

Collateral

At the loan closing, the State of Idaho receives collateral, typically a sewer revenue bond, local improvement district bond, or promissory note, from the borrower. As of June 30, 2010, the Office of the State Treasurer held \$81,368,126 (at original face value) in Bonds and \$45,980,311 (at original face value) in promissory notes as collateral for the CWSRF.

Loans by Category

Completed projects are loans in the repayment phase. Projects in progress are in construction or the disbursement phase. Loans that have been paid in full are excluded. This is a format change from 2009. Loans receivable at June 30, 2010, are as follows:

	<u>Loan Authorized</u>	<u>Principal Repayments</u>	<u>Remaining Commitment</u>	<u>Receivable Balance</u>
Completed Projects	\$147,050,150	\$30,218,157	\$0	\$116,831,993
Projects in Progress	<u>120,134,347</u>	<u>0</u>	<u>71,985,529</u>	<u>48,148,818</u>
Totals	<u>\$267,184,497</u>	<u>\$30,218,157</u>	<u>\$71,985,529</u>	164,980,811
Less: Amount Due Within 1 Year (Current)				<u>5,766,026</u>
Loans Receivable, Net of Current Maturities				<u>\$159,214,785</u>

The projected principal repayments in subsequent years are as follows:

<u>Year Ending June 30:</u>	<u>Amount</u>
2011	\$5,766,026
2012	6,996,635
2013	8,080,912
2014	8,274,268
2015	8,539,892
Thereafter	<u>127,323,078</u>
Total Loans Receivable	<u>\$164,980,811</u>

Major Loans to Idaho Agencies

As of June 30, 2010, the CWSRF had made loans to the agencies listed below that, in aggregate by agency, exceeded \$10 million. This threshold was \$4.9 million for 2009. The outstanding balance of these loans represents approximately 61% of the total loan receivable, as follows:

<u>Local Agency</u>	<u>Authorized Loan</u>	<u>Outstanding Balance</u>
North Lake Sewer and Water District	\$34,361,552	\$28,447,432
City of Coeur d'Alene	28,000,000	13,667,964
City of Pocatello	22,630,315	17,902,915
City of Ammon	20,000,000	11,094,043
City of Chubbuck	19,802,034	4,856,746
City of Burley	16,928,564	15,699,749
City of Boise	<u>10,528,098</u>	<u>8,241,859</u>
Totals	<u>\$152,250,563</u>	<u>\$99,910,708</u>

The current loan amount includes projects in construction and projects in the repayment phase. Loans that have been fully repaid are excluded. As of June 30, 2010 principal repayments on completed projects still in the repayment phase was \$15,070,497, and remaining amounts to be disbursed on projects in construction was \$37,269,358.

NOTE 4. INTEREST RECEIVABLE

The interest rate on loans ranges from 0% to 4.5% and loans are generally repaid over 20 years (30 years for some disadvantaged communities) starting within one year after the project is completed. Details of loan interest receivable as of June 30, 2010, are as follows:

<u>Interest Receivable by Category</u>	
Completed Projects	\$1,743,959
Projects in Progress	<u>675,018</u>
Total Interest Receivable	<u>\$2,418,977</u>

NOTE 5. CONTINGENCIES

The CWSRF is exposed to various risks of loss related to torts, thefts of assets, errors or omissions, injuries to State employees while performing CWSRF business, or acts of God. The CWSRF maintains insurance (through the Idaho State Department of Administration, Bureau of Risk Management) for all risks of loss. The cost of insurance is included in the indirect costs charged to the CWSRF. There have not been any claims against the CWSRF since its inception in 1989.

NOTE 6. CONTRIBUTED CAPITAL AND FUND BALANCE

The CWSRF is capitalized by EPA grants authorized by Title VI of the Act and matching funds from the State. All funds drawn are recorded as contributed capital from the EPA and the State. As of June 30, 2010, the EPA has awarded \$130,239,715 in capitalization grants to the State, of which \$130,239,715 has been drawn for loans and administration of the CWSRF. The State has provided the required matching funds of \$26,047,943. The following schedule summarizes the capitalization grants awarded by federal fiscal year, amounts drawn on each grant as of the balance sheet date, and balances available:

<u>Year</u>	<u>EPA Grant Amount</u>	<u>Total Draws at June 30, 2009</u>	<u>Draws During SFY 2010</u>	<u>Total Draws at June 30, 2010</u>	<u>Balance at June 30, 2010</u>
1989	\$4,577,200	\$4,577,200	\$0	\$4,577,200	\$0
1990	4,738,000	4,738,000	0	4,738,000	0
1991	10,343,215	10,343,215	0	10,343,215	0
1992	9,534,900	9,534,900	0	9,534,900	0
1993	9,431,000	9,431,000	0	9,431,000	0
1994	5,813,800	5,813,800	0	5,813,800	0
1995	6,007,800	6,007,800	0	6,007,800	0
1996	6,318,400	6,318,400	0	6,318,400	0
1997	6,576,800	6,576,800	0	6,576,800	0
1998	6,577,300	6,577,300	0	6,577,300	0
1999	6,577,900	6,577,900	0	6,577,900	0
2000	6,555,200	6,555,200	0	6,555,200	0
2001	6,496,100	6,496,100	0	6,496,100	0
2002	6,510,800	6,510,800	0	6,510,800	0
2003	6,467,800	6,467,800	0	6,467,800	0
2004	6,471,800	6,471,800	0	6,471,800	0
2005	5,243,500	5,243,500	0	5,243,500	0
2006	4,242,300	4,242,300	0	4,242,300	0
2007	5,207,300	5,207,300	0	5,207,300	0
2008	3,274,300	3,274,300	0	3,274,300	0
2009	<u>3,274,300</u>	<u>0</u>	<u>3,274,300</u>	<u>3,274,300</u>	<u>0</u>
Totals	<u>\$130,239,715</u>	<u>\$126,965,415</u>	<u>\$3,274,300</u>	<u>\$130,239,715</u>	<u>\$0</u>

As of June 30, 2009 and 2010, the State match contributions were:

	<u>Total Match Provided at June 30, 2009</u>	<u>State Match Provided in SFY 2010</u>	<u>Total Match Provided at June 30, 2010</u>	<u>Available State Match Balance at June 30, 2010</u>
Idaho CWSRF	\$25,393,083	\$654,860	\$26,047,943	\$0

NOTE 7. AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

The American Recovery and Reinvestment Act of 2009 (ARRA) will provide the Idaho CWSRF with up to \$29,239,100 of federal funds, with no required State match. The ARRA funds will come from the following: \$19,239,100 from the U.S. EPA and \$10,000,000 from the U.S. Department of Education.

The EPA ARRA funds came with numerous requirements including:

- 1) The projects selected were to be "shovel ready" and under contract by February 17, 2010.
- 2) Additional subsidization of projects in the amount of at least 50% of the ARRA grant. Idaho has chosen to provide principal forgiveness to meet this requirement.
- 3) Not less than 20% of the ARRA grant was to go to Green Project Reserve, defined as green infrastructure, water or energy efficiency improvements, or other environmentally innovative activities.

Additional information regarding the American Recovery and Reinvestment Act can be found at the "www.deq.idaho.gov/water/arra/arra_water_projects.cfm" and "www.recovery.gov" websites.

Loan disbursements to qualified projects for incurred costs are necessary to collect these funds. As of June 30, 2010, \$3,396,148 (17.7% of available funds) of U.S. EPA ARRA and \$3,145,520 (31.5%) of U.S. Education ARRA loan disbursements have been made.

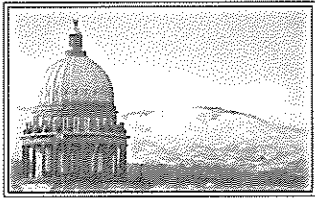
NOTE 8. FINANCIAL STATEMENT PRESENTATION

The accompanying financial statements have been presented in a three column format beginning this year. The new format, which separates loan activities and administrative activities and then combines them, will allow the user to get a better understanding of the respective costs. Loan activities include loan disbursements, collections, interest earned, contributions from the EPA and the State for loan disbursements. Administrative activities include expenses and contributions from the EPA and loan servicing fees.

NOTE 9. SUBSEQUENT EVENT

North Lake Recreational Sewer and Water District (North Lake) has defaulted on CWSRF Loans 1899-09, 1899-16, and 1899-18. Scheduled repayments due to the State after June 30, 2010 were not made and remain unpaid at this time.

DEQ is taking an active role in monitoring and assisting North Lake's efforts at securing repayments. The district court has recently confirmed North Lake's statutory priority above other creditors in the Tamarack Resort foreclosure proceeding. Tamarack Resort comprises a majority of the local improvement district assessments in the three delinquent loans. On September 1, 2010, North Lake filed a claim against Tamarack Resort LLC for approximately \$36 million in the Tamarack bankruptcy action.



Legislative Services Office Idaho State Legislature

Serving Idaho's Citizen Legislature

Jeff Youtz
Director

December 15, 2010

Independent Auditor's Report on Internal Control over
Reporting and on Compliance and Other Matters Based
on an Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards*

Tony Hardesty, Director
Idaho Department of Environmental Quality
Statehouse Mail

Dear Ms. Hardesty:

We have audited the financial statements of the Idaho Department of Environmental Quality, Clean Water State Revolving Fund's (CWSRF) as of and for the year ended June 30, 2010, and have issued our report thereon dated December 15, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the CWSRF's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Mike Nugent, Manager
Research & Legislation

Cathy Holland-Smith, Manager
Budget & Policy Analysis

Don H. Berg, Manager
Legislative Audits

Glenn Harris, Manager
Information Technology

Statehouse, P.O. Box 83720
Boise, Idaho 83720-0054

Tel: 208-334-2475
www.legislature.idaho.gov

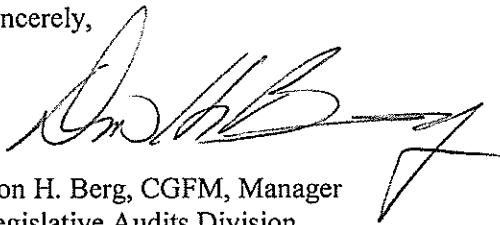
Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies that are also considered to be material weaknesses. We consider the deficiencies described in Finding 1 to be significant deficiencies in internal controls over financial reporting. We also consider this significant deficiency to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the CWSRF's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Idaho Department of Environmental Quality and the Idaho Legislature and is not intended to be used by anyone other than these specified parties.

Sincerely,

A handwritten signature in black ink, appearing to read 'Don H. Berg', with a long horizontal flourish extending to the right.

Don H. Berg, CGFM, Manager
Legislative Audits Division

FINDING AND RECOMMENDATION

FINDING 1

Material errors in the financial statements were not detected by current internal control procedures.

Internal controls are essential to ensure that financial statements and related notes are accurate and complete. We identified the following material errors and omissions in the financial statements:

- The investment balance was understated by \$2,425,972 due to use of improper market value.
- Investment revenue was understated by \$1,520,730 in the current period and required a \$905,241 restatement of beginning net assets.
- Current fees receivable were overstated by \$338,088 because non-current receivables were improperly included in the amount.
- Statement of Cash Flows was missing a required disclosure for the change in investment value

While the Department corrected these errors on the financial statements, they do indicate that internal control weaknesses exist which should be addressed to reduce the risk of future errors and omissions.

RECOMMENDATION

We recommend that the Department review and strengthen the internal controls and processes for preparing financial statements and notes to reduce the risk of errors and omissions.

AGENCY'S RESPONSE AND CORRECTIVE ACTION PLAN

The Department disagrees with the finding. The Department agrees that while working drafts of the financial statements did not have certain assets presented correctly, the final version of the financial statements did. Department staff consulted with the auditors on numerous occasions during the completion of the statements in regard to the proper classification of assets. The auditors' recommendation states that the Department needs to "review and strengthen the internal controls and processes for preparing the financial statements." The Department agrees to some extent, but would also conclude that the staff did in fact consult with "experts" and agreed with the recommendations provided. In the future, the Department will make sure that the auditors are aware that the draft statements provided to them, at their request, will be identified more clearly as working documents.

AGENCY RESPONSE



STATE OF IDAHO
DEPARTMENT OF
ENVIRONMENTAL QUALITY

1410 North Hillon • Boise, Idaho 83706 • (208) 373-0502

C.L. "Butch" Otter, Governor
Toni Hardesty, Director

December 15, 2010

Mr. Don Berg, CGFM, Division Manager
Legislative Audits
954 West Jefferson
Boise, Idaho 83720

Re: Audit Report – 2010 Clean Water Revolving Fund

Dear Mr. Berg:

The Department of Environmental Quality accepts the audit report. We appreciate the work of Eric Bjork and J. E. Bowden of your audit staff.

If you or your staff have any further questions, please contact Dave Sande, CPA, Financial Officer.

Sincerely,

A handwritten signature in black ink, appearing to read "Toni", followed by a long, horizontal, wavy line.

Toni Hardesty
Director

cc: Dave Sande, DEQ-Fiscal Office

APPENDIX

HISTORY AND STATUTORY AUTHORITY

The Idaho Clean Water State Revolving Fund (CWSRF) was established pursuant to Title VI of the Federal Clean Water Act of 1987. The CWSRF has been capitalized by a series of grants from the U.S. Environmental Protection Agency beginning in 1989.

PURPOSE

The Act established the CWSRF program to provide loans at reduced rates to finance the construction of publicly owned water pollution control facilities. Instead of making grants to communities that pay for a portion of building wastewater facilities, the CWSRF provides a flexible financing source that can be used for a variety of pollution control projects. Loans made by the CWSRF must be repaid within 20 years, and all repayments, including interest and principal, must remain in the CWSRF.

ORGANIZATION AND STAFFING

The CWSRF is administered by the Idaho Department of Environmental Quality (DEQ). The CWSRF has no full-time employees, but instead uses DEQ employees on a part-time basis. The part-time positions include the CWSRF's loan program manager, senior accountant, loan program specialist, lead loan officer, water quality analyst, six regional managers, and several staff and technical engineers.

Department of Environmental Quality
Organizational Structure

